



Global Markets Monitor

Monetary and Capital Markets Department
Global Markets Analysis Division

Wednesday, September 12, 2018

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- **Persistent gap between Fed dots and market may mean more curve flattening** ([link](#))
- **Members of UK's Conservative Party reportedly discuss No Confidence vote** ([link](#))
- **PBC resumes open market operations** ([link](#))
- **Brazilian assets sell off modestly on fluctuating presidential election polls** ([link](#))
- **Argentina leaves policy rate unchanged at 60%, as expected** ([link](#))
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Central bank decisions loom

Price action was limited yesterday and overnight, as investors eye tomorrow's central bank decisions. The ECB and Bank of England both wrap up meeting tomorrow, with neither expected to change their policy rates. However, investors will be interested in any revisions to the ECB's forecasts and/or any change in tone at President Draghi's press conference. Additionally, the Central Bank of the Republic of Turkey (CBRT) concludes its policy meeting tomorrow, with market participants widely expecting a significant hike in the 1-week repo policy rate (Bloomberg consensus 325 bps). Contacts note that a smaller-than-expected policy rate hike could touch off another round of lira weakness. Elsewhere, trade remains a worrisome backdrop, with little progress seen in US-China talks.

Key Global Financial Indicators

Last updated: 9/12/18 8:01 AM	Level		Change from Market Close				YTD
	Last 12m	Index	1 Day	7 Days	30 Days	12 M	
Equities			%				%
S&P 500		2888	0.4	0	2	16	8
Eurostoxx 50		3319	0.2	0	-3	-5	-5
Nikkei 225		22605	-0.3	0	1	16	-1
MSCI EM		41	0.2	-3	-5	-9	-13
Interest Rates			bps				
US 10y Yield		2.96	-1.5	6	9	79	56
Germany 10y Yield		0.41	-2.0	3	9	1	-2
Japan 10y Yield		0.11	-0.2	0	1	9	7
FX / Commodities / Volatility			%				
Dollar index, (+) = \$ appreciation		95.2	-0.1	0	-1	4	3
Brent Crude Oil (\$/barrel)		79.2	0.2	3	9	46	18
VIX Index (% change in pp)		13.1	-0.1	-1	0	2	2

Colors denote **tightening**/**easing** financial conditions for observations greater than ± 1.5 standard deviations. Data source: Bloomberg.

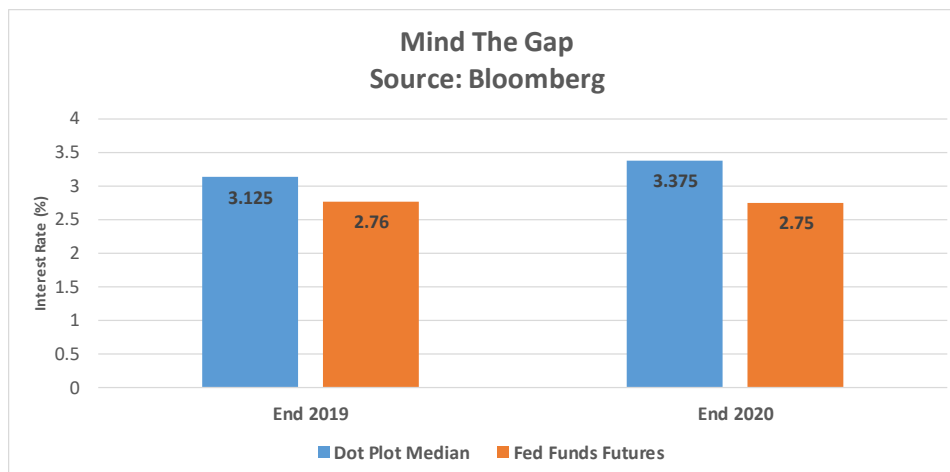
United States

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Tuesday saw a more active session as US stocks posted modest gains and Treasury yields were 4 to 5 bps higher across the curve. At 2.98%, the 10-year yield was at its highest level in more than five weeks and seemed close to testing the psychologically important 3% level. The market crossed 3% several times this year and went as high as 3.11% on May 17, but each time safe-haven buying ended up driving the yield back below 3%. Meanwhile, Tuesday's equity gains were broad based, and the S&P 500 closed to within 1% of its August 29 record. Today, investors are looking forward to the widely followed annual iPhone launch in the hope that a strong holiday quarter for Apple could boost the rest of the technology sector and the stock market more generally.

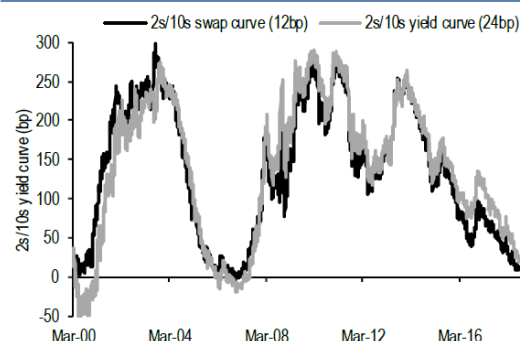
This morning, August PPI showed an unexpected decline of 0.1% mom (consensus +0.2% mom). The 2-year Treasury rate dipped modestly immediately following the release and the US dollar weakened slightly against the euro.

The gap between the dot plot and the market remains substantial, with the market more dovish than the FOMC estimates for future short-term rates. Many investors believe that the yield curve will continue to flatten until the gap is eliminated. Most think it will be the Fed that adjusts its median expectation downwards, gradually lowering its 2019 and especially its 2020 projections. At present, December 2019 Fed Funds futures are trading at 2.76% versus the end-2019 median FOMC projection of 3.125%. The December 2020 is trading at roughly the same level versus the 3.375% end-2020 forecast, implying that the market thinks there will be no rate hikes at all in 2020. The euro-dollar futures curve is also nearly flat between December 2019 and December 2020.



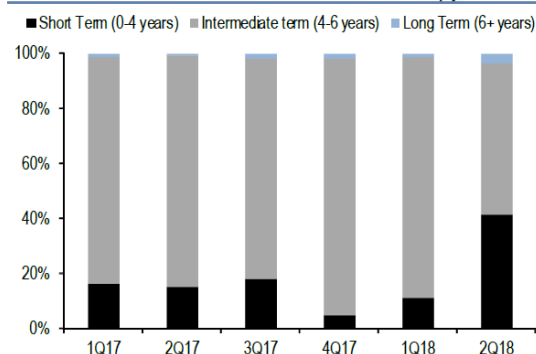
The flattest US cash Treasury and interest rate swap curves since the global financial crisis have boosted demand for short maturity bond funds. If the curves continue to flatten as most expect, this demand is likely to rise even higher. Some analysts have speculated that the high demand could drive short term money market rates lower, making for a less turbulent year-end funding market for banks. Cross-currency basis swap funding costs and other measures of short term interest costs tend to spike up sharply over year-end in recent years. The 2017-18 episode was the most severe since the height of the European crisis in 2011. The year-end "turns" in 2015, 2016 and 2017 also saw similar if much smaller occurrences.

Chart 79: In 2018 the 2s/10s Treasury and swaps curves each flattened to their narrowest respective levels since 2007



Source: Bloomberg

Chart 80: Inflows into short-term U.S. bond funds increased sharply in 2Q 2018



Source: BofA Merrill Lynch Global Research, EPFR

US auto loan debt has risen to \$1.24 tn and the proportion of 90+ day delinquencies has experienced a sharp increase to 4.17%, the latest New York Fed data show. The notional value of delinquent debt has now reached \$52 bn. Although the numbers are still low in absolute terms, the rate of increase is a concern. In addition, the Fed data shows that the credit quality (FICO scores) of borrowers is getting worse and that some loan originators are straying from proper underwriting practices. There is evidence of inadequate income verification, more tolerance for low FICO scores, and allowing borrowers to roll their negative equity from older loans into new loans. Analysts have expressed concern that credit deterioration could put US car companies under pressure. Moody's downgraded Ford to Baa3 with a negative outlook on August 29.

Europe

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Sovereign debt yields are steady ahead of the ECB meeting tomorrow and Italian, German, and Portuguese debt auctions later this week. Ten-year yields are at: 0.42% (-1 bp) in Germany and 0.72% (-1 bp) in France. **Broad equity indices moved higher by about 0.6%.** **Bank stocks underperformed** in Europe (-0.5%) and the UK (-0.3%), however, as most analysts don't expect interest rate hikes. Net NPLs at Italian banks fell to €40.1 bn in July – their lowest level since Dec. 2010, according to the latest Bank of Italy data.

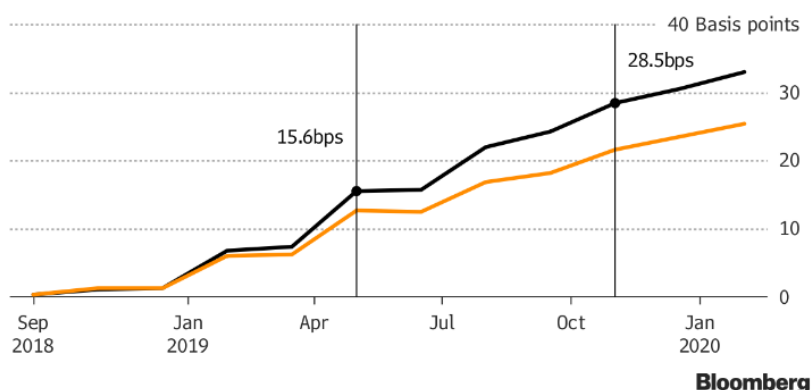
News outlets report on a meeting in Westminster last night where 50 euroskeptic MPs discussed options to oust PM Theresa May. A formal no-confidence vote would require the initial support of 48 MPs, but the actual removal of PM May would have to be approved by 158 votes in parliament. Analysts doubt that such support could be garnered in a formal challenge to May, as it could risk a Labour victory in new elections. Separately, chancellor Hammond announced to parliament that **BoE governor Camey will remain at his post until January 2020**, instead of his planned departure in June 2019. The extension seeks to provide stability around the Brexit date in March 2019.

The BoE is expected to leave interest rates unchanged tomorrow. Market expectations derived from options trading give a 60% chance to a hike in May 2019, and price a full hike no earlier than November 2019. Yields on 10-year gilts are at 1.49% (-1 bp) this morning, while sterling (-0.1%) is slightly weaker at \$1.30.

BOE Rate Outlook

May is in play while quarter-point hike fully priced for November 2019

Traders projections as of Sept. 11 Sept. 6



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Japan

The yen gained for the first time in 4 days while equities weakened. The yen advanced (+0.14%) on the back of renewed global trade tensions. Against this backdrop, losses in the shares of electronics makers weighed on the Topix, which shed 0.5%, its first decline in 3 days. The BoJ's offer to buy ¥450 bn of 5- to 10-year JGBs saw a bid-cover ratio of 2.3x, the lowest since May 2017. Traders noted that expectations for JGB volatility to remain subdued have trimmed investor participation. Moreover, most expect the BoJ to refrain from reducing its outright purchases as yields are likely to remain near current levels. Both the 2- and 5-year note were unchanged on the day, holding steady at -0.11% and -0.08%, respectively. The yield on the 10-year note fell 0.7 bps to 0.10%.

Emerging Markets [back to top](#)

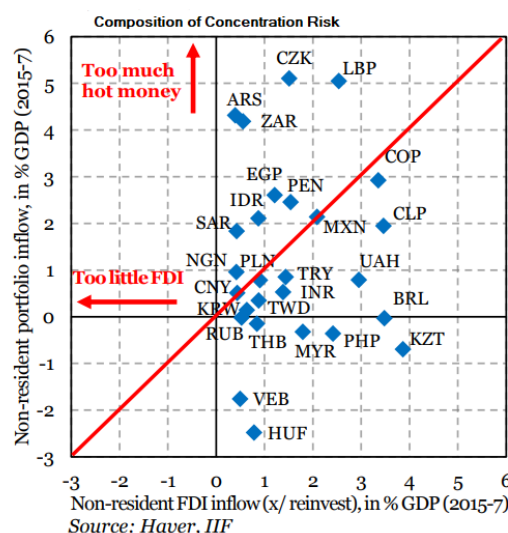
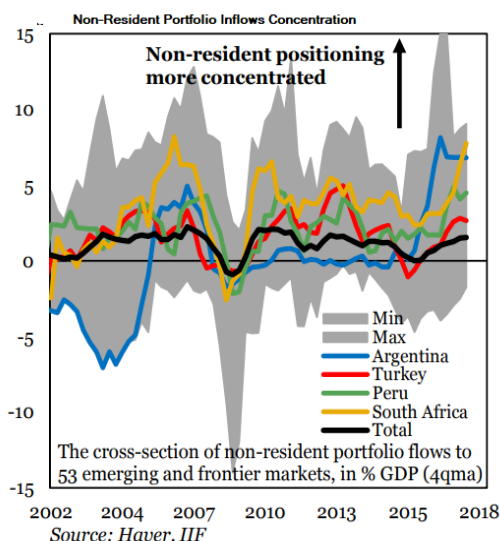
Key Emerging Market Financial Indicators

Last updated: 9/12/18 8:02 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Prices/Returns of Major EM Benchmarks			%				%
MSCI EM Equities		41.23	0.2	-3	-5	-9	-13
MSCI Frontier Equities		27.61	-0.1	0	-4	-11	-17
Hard Currency Sovereign Debt		813.47	-0.1	0	-1	-5	-5
Local Currency Sovereign Debt		15.86	-0.1	0	-4	-19	-16
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.87	0.1	-1	0	-5	-5
Indonesian Rupiah		14813	0.2	1	-1	-11	-8
Indian Rupee		72.21	0.4	-1	-3	-11	-12
Argentine Peso		37.95	0.0	2	-21	-55	-51
Brazil Real		4.15	0.0	0	-6	-25	-20
Mexican Peso		19.18	0.0	1	0	-8	2
Russian Ruble		69.47	-0.1	-2	-3	-17	-17
South African Rand		15.08	-0.1	2	-4	-14	-18
Turkish Lira		6.37	1.0	4	8	-46	-40
Dollar vs. Mature FX (DXY index)		95.20	-0.1	0	-1	4	3

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Emerging market assets came under pressure yesterday but seem to have stabilized into the European open. Declines in EM currencies over the last two sessions were led by Brazil and Argentina (both -1.5%), but the Russian ruble appreciated by 1.7% on talk of rate hikes and higher oil prices. Currencies of South African, Turkey and Mexico are all up over 0.5% over the same period. In Asia, a sizable portion of EM currencies recovered some losses, attributable to a lack of negative trade headlines. EM equity markets closed broadly lower yesterday and overnight in Asia, but are rising in Eastern Europe this morning led by a 1% gain in Turkey.

Analysts have argued that there is a strengthening US dollar could pose a broad risk to emerging markets. Market participants explain that countries with large current account deficits, and who rely on external funding (Argentina, Turkey, South Africa) are likely to experience increasing pressure in the future if the US dollar continues to strengthen. Meanwhile, IIF analysis suggests that another source of vulnerability lies in the high debt burdens in some EMs and frontier markets. Specifically, they argue that the speed of previous inflows, as well as their composition, places some countries at greater risk. For instance, countries who experienced a rapid pace of non-resident inflows relative to their GDP after the 2015/16 RMB devaluation include Argentina, Turkey, and South Africa, but also other frontier markets like Egypt and Lebanon. Additionally, the capital flows were mainly non-resident portfolio inflows, rather than FDI inflows, which are more stable and can provide a buffer.



China

The PBC resumed open market operations for the first time in 15 days to support market liquidity.

In its first operation since August 21st, the PBC offered RMB 60 bn (\$8.7 bn) in its 7-day reverse repos operation and kept the interest rate unchanged at 2.55%. In a statement posted on the PBC's website, the central bank noted that the injections will help offset the impact of corporate tax payments and government bond sales, and ensure liquidity is "reasonable" and "ample" within the banking system. The one-week Shanghai Interbank Offered Rate had risen to 2.69% on Tuesday, the highest level since mid-July. Meanwhile, despite expectations for softening growth and trade headwinds, higher funding costs, combined with a faster-than-expected inflation print in August, lifted yields on central government bonds. In its eighth consecutive increase, the 5-year note rose (+3 bps) to 3.52% on the day, its highest in 3 months. By contrast, following the liquidity operation, the 7-day interbank repo rate fell 14 bps to 2.53%. In currencies, **the RMB held steady as market sentiment stabilized.**

Argentina

Argentina's central bank kept the 7-day policy rate unchanged at 60% and pledged to maintain a restrictive monetary stance until at least December 2018. The monetary policy committee (MPC) communicated that it will also apply corrective measures to meet its inflation targets if necessary. Concerning inflation, the MPC noted that despite its current disinflationary measures, prices may remain high, given the current environment of FX volatility. During trading hours, the Merval was down 1%, while the peso depreciated by 1.6%.

Brazil

Brazil's stock market decline 2.6% on Tuesday, and the *real* depreciated 1.7% against the dollar, as official poll results showed left-wing election candidates gaining popularity. Sovereign bonds and notes from state-run companies also declined, as investors worried that a candidate from the left (such as PT's Haddad) could win the election and reverse efforts to improve Brazil's fiscal accounts. However, following the market close, the new Ibope poll showed right-wing candidate Bolsonaro extending his lead. The main uncertainty appears to be to what extent support for ex-president Lula can be transferred to Haddad. Contacts still believe that the most likely outcome is a runoff election between Bolsonaro and Haddad, but it is very difficult to predict who would win in this case.

Latest Polls For Brazil

	IBOPE		DATAFOLHA	
	Last	Prior	Last	Last
Bolsonaro	26	22	24	22
Marina	9	12	11	16
Ciro	11	12	13	10
Alckmin	9	9	10	9
Haddad	8	6	9	4


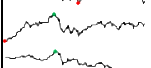


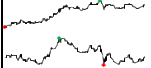
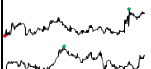

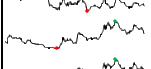

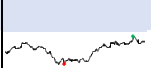
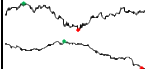
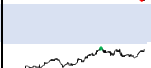


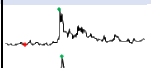


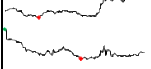





Indonesia

The Indonesian rupiah strengthened modestly as authorities sought to tighten FX rules on exporters to support the currency. In an interview with Bloomberg, Finance Minister Indrawati noted that foreign exchange earnings from exports will be kept in the country to support efforts by the government to rein in the current-account deficit and shield the rupiah. According to central bank data, exporters repatriated more than 90% of their earnings in Q2, but only converted 14% of these earnings to rupiah. Meanwhile, Bank Indonesia has raised interest rates 4 times since May as the currency has depreciated 6.5% against the dollar since that time. The rupiah gained 0.2% on the day. At the current level of 14,833, it is roughly 0.7% stronger relative to the two-decade low reached two weeks ago.

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Global Financial Indicators

Last updated: 9/12/18 8:03 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		2888	0.4	0	2	16	8
Europe		3319	0.2	0	-3	-5	-5
Japan		22605	-0.3	0	1	16	-1
China		2656	-0.3	-2	-5	-21	-20
Asia Ex Japan		68	0.3	-3	-4	-6	-11
Emerging Markets		41	0.2	-3	-5	-9	-13
Interest Rates			basis points				
US 10y Yield		2.96	-1.5	6	9	79	56
Germany 10y Yield		0.41	-2.0	3	9	1	-2
Japan 10y Yield		0.11	-0.2	0	1	9	7
UK 10y Yield		1.48	-2.0	4	24	35	29
Credit Spreads			basis points				
US Investment Grade		102	-1.3	-2	0	-10	11
US High Yield		339	-5.2	-5	-8	-58	-36
Europe IG		62	1.1	-4	-8	10	17
Europe HY		283	2.6	-9	-26	55	49
EMBIG Sovereign Spread		375	3.0	-2	20	85	90
Exchange Rates			%				
Dollar Index (DXY)		95.20	-0.1	0	-1	4	3
USDEUR		1.16	-0.3	0	1	-3	-4
USDJPY		111.5	0.1	0	-1	-1	1
EM FX vs. USD		60.5	0.2	0	-3	-15	-13
Commodities			%				
Brent Crude Oil (\$/barrel)		79	0.2	3	9	46	18
Industrials Metals (index)		115	0.5	-1	-6	-12	-17
Agriculture (index)		42	-0.1	0	-4	-13	-11
Implied Volatility			%				
VIX Index (% change in pp)		13.1	-0.1	-0.8	-0.1	2.4	2.1
10y Treasury Volatility Index		3.5	-0.1	-0.3	-0.4	-0.8	0.0
Global FX Volatility		9.1	0.0	0.1	0.1	0.9	1.7
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		410	1.2	-45	-12	-135	-1
Italy		293	-1.1	0	-6	91	92
Portugal		187	-2.8	-1	9	-98	-8
Spain		146	-0.5	1	6	-14	-11

Colors denote **tightening**/**easing** financial conditions for observations greater than ± 1.5 standard deviations.

Data source: Bloomberg.

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Emerging Market Financial Indicators

Last updated: 9/12/2018 8:03 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
	vs. USD		(+)= EM appreciation					% p.a.						
China		6.87	0.1	-0.5	0	-5	-5		3.6	1.3	6	15	-9	-34
Indonesia		14813	0.2	1.0	-1	-11	-8		8.7	0.0	23	84	201	206
India		72	0.4	-1.0	-3	-11	-12		8.3	1.6	10	34	137	82
Philippines		54	-0.3	-0.8	-1	-6	-7		6.2	1.5	28	28	137	135
Thailand		33	-0.1	-0.1	2	1	-1		2.9	1.6	4	8	64	55
Malaysia		4.15	0.0	0.2	-1	1	-2		4.1	0.0	3	7	30	22
Argentina		38	0.0	1.8	-21	-55	-51		24.8	0.3	-1	351	919	879
Brazil		4.15	0.0	-0.2	-6	-25	-20		10.5	5.3	-17	49	178	150
Chile		696	0.1	-1.4	-5	-11	-12		4.8	0.1	6	1	43	2
Colombia		3082	0.0	0.5	-2	-6	-3		6.7	-3.3	10	15	28	40
Mexico		19.18	0.0	0.8	0	-8	2		8.1	2.1	5	30	119	42
Peru		3.3	0.0	-0.5	-1	-3	-3		5.6	1.0	7	13	19	38
Uruguay		33	0.5	-0.1	-4	-12	-12		11.6	-4.2	18	133		306
Hungary		282	-0.6	0.0	1	-9	-8		2.6	6.0	6	3	93	134
Poland		3.72	-0.5	-0.1	1	-4	-6		2.6	0.2	5	10	7	-4
Romania		4.0	-0.4	-0.4	2	-4	-3		4.3	2.0	-2	-1	152	50
Russia		69.5	-0.1	-1.8	-3	-17	-17		8.7	-22.1	16	58	118	137
South Africa		15.1	-0.1	2.3	-4	-14	-18		9.8	-2.9	1	35	56	47
Turkey		6.37	1.0	3.7	8	-46	-40		23.0	49.5	-18	71	1245	1106
US (DXY; 5y UST)		95	-0.1	0.0	-1	4	3		2.85	-1.4	9	11	111	65

	Equity Markets							Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		2656	-0.3	-2	-5	-21	-20		188	3	1	-2	38	36
Indonesia		5798	-0.6	-2	-5	-1	-9		211	2	4	21	38	45
India		37718	0.8	-1	0	18	11		174	4	13	18	42	64
Philippines		7449	-0.9	-4	-5	-7	-13		107	0	-4	-2	16	12
Malaysia		1785	-0.8	-2	-1	0	-1		136	2	0	-3	3	26
Argentina		29164	-1.0	6	9	21	-3		743	1	-1	42	349	393
Brazil		74657	-2.3	-2	-2	0	-2		331	2	-4	38	74	97
Chile		5212	0.2	1	-1	1	-6		138	0	-4	-4	11	19
Colombia		1481	0.6	-3	-3	-2	-2		187	2	5	-6	-2	13
Mexico		48896	0.1	0	1	-3	-1		282	1	-3	-7	40	37
Peru		18758	0.0	-1	-7	4	-6		146	0	-2	-13	3	9
Hungary		36235	-0.4	-2	0	-4	-8		115	2	-6	-11	25	27
Poland		57469	-0.2	-2	-2	-11	-10		54	2	-6	-14	6	7
Romania		8301	0.2	0	2	3	7		187	0	3	6	58	73
Russia		2342	0.3	1	3	15	11		247	-1	9	8	74	69
South Africa		56098	-0.1	-2	-3	0	-6		357	5	-2	63	103	103
Turkey		93242	0.9	0	-2	-15	-19		550	4	-50	60	275	261
Ukraine		529	-0.3	0	4	82	68		585	-10	-33	40	122	130
EM total		25	-0.1	-3	-3	-4	-7		375	3	-2	20	85	90

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.